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SUBJECT: THAI TELECOM ROUNDUP: MERGE OR DIE?

REF: A. 05 BANGKOK 6901 (Telenor Buys out UCOM and TAC)
[¶](#)B. 06 BANGKOK 583 (Deal of the Century)
[¶](#)C. 06 BANGKOK 1549 (Shin Corp Deal is Legal: So What?)
[¶](#)D. 05 BANGKOK 7124 (Court Suspends Privatization of EGAT)
[¶](#)E. 06 BANGKOK 115 (Licenses without Concession Conversion)

[¶](#)1. SUMMARY: The takeover of Thailand's two leading mobile phone providers by foreign companies and the political crisis unleashed by the prime minister's family's sale of its stake in Shin Corporation to Temasek of Singapore has fundamentally altered the context of both the telecom business and regulatory policy. The National Telecommunications Commission faces political protest against the sale of national assets to foreigners and consumer impatience with a deterioration in the quality of mobile phone services. Prime Minister Thaksin's policies of privatization of state-owned enterprises (SOEs) and trade liberalization are stalled and the government's "caretaker" status has led to a shift in power in favor of SOEs TOT Plc and Cat Telecom Plc. Dashed expectations of conversion of the concessions previously granted by the SOEs to private companies, of the rollout of third-generation (3G) services, and of allocation of new frequencies have forced a reassessment of where the sector is headed. A leading telecom analyst offers a solution in the form of merges between SOEs and listed companies that is useful for identifying the issues at stake. In response to the above environment, the regulator is drafting regulations on foreign business control and interconnection, among others. While unlikely to be of great consequence either to telecom companies or the sector as a whole, the Embassy thinks that the regulations on foreign business control will have a net negative effect on shareholder rights and investment opportunity in Thailand's telecom sector. END SUMMARY

NEW ENVIRONMENT FOR THE THAI TELECOM SECTOR

[¶](#)2. AFTERMATH OF THE SHIN AND TELENOR DEALS: The exit of the Shinawatra and Bencharonkul families from the Thai telecom sector has fundamentally altered the context within which all players in the industry now operate. As set out in REFs A and B, the two largest mobile telecom services providers, Advanced Info Service Plc (AIS) and DTAC, although still legally Thai-owned, are effectively foreign-controlled entities as a result of the takeover of Shin Corporation by Singapore's Temasek Holdings and the buyout of both UCOM and Total Access Communications (TAC) by Norway's Telenor. The takeover of Shin, the parent company of AIS and the larger of the two, has sparked a political crisis in which economic nationalism has flourished. Popular protest against both the foreign purchase of Thai assets and Prime Minister Thaksin's policies of sectoral and trade liberalization has become a staple of Thai political life (REF C). Ironically, the self-proclaimed reformers such as Rosana Tositrakul, now Bangkok senator-elect, who criticize Prime Minister Thaksin and his "cronies" from reaping ill-gotten gain from RTG policies, have emerged as defenders of Thailand's monopolistic and inefficient SOEs.

[¶](#)3. PRIVATIZATION ON THE ROPES: The Thaksin government's own missteps in privatizing SOEs in other sectors have spilled over into

the telecom arena. The March 2005 court-ordered annulment of the RTG's corporatization of the Electric Generating Authority of Thailand (EGAT), the principal state-owned electric power utility, in conjunction with a November 2005 ruling suspending the initial public offering of shares of the corporatized entity further reduce the likelihood that the government will proceed with the privatization of either TOT Plc or CAT Telecom Plc in the near future (REF D).

14. RTG POLICY ON HOLD: Reinforcing this unexpected political rehabilitation of Thailand's state-owned enterprises has been a shift in bureaucratic power in favor of the TOT and CAT Telecom. While the RTG is in "caretaker" status, policy initiatives have been on hold because the bureaucrats are hesitant to act on anything other than routine business. With no exit from the current political crisis in view, private investors have likewise decided to postpone major decisions. Additionally, the Ministry of Information and Communications Technology (MICT) is headed by an acting caretaker minister. Mr. Sora-at Klingpratoom, who had advocated listing both TOT and CAT, has stepped down as minister in a move in the factional politics within the ruling Thai Rak Thai Party.

15. CHANGING OF THE GUARD AT TOT: Within TOT, the old guard has similarly rebounded. The TOT board of directors dismissed President Teerawit Charuwat effective May 12, ostensibly for financial underperformance and the failure to effect an initial public offering of shares. Mr. Teerawit was formerly finance chief at the state broadcaster MCOT Plc. He was chosen in 2005 over several senior TOT executives for the position. In his defense, Mr. Teerawit claimed that the extra expenditures of 1.14 billion baht last year that cut into profitability were for one-off items such as licenses. Without them, net profit would have risen 9.4 percent to 10.57 billion baht. He also attributed problems he experienced to political interference and lack of cooperation from the senior executives. Chamras Tantrisukorn, a senior executive, was named acting president.

THE NEW POLITICAL LANDSCAPE FOR THE NTC . . .

16. THE NTC IN THE SPOTLIGHT: With this shift in the balance of power, the challenges facing the National Telecommunications Commission (NTC), the sector's regulator, have changed. The exit of the prime minister's family from the sector has removed an incalculable political weight from the NTC's shoulders, and thereby changed the dynamics of the interaction among the commissioners and the private telecom companies. At the same time, the popular political outcry over the foreign purchase of the Shinawatra family's assets has put the NTC on the spot, particularly its administration of the provisions of the 2001 Telecommunications Business Act (TBA) concerning foreign ownership, which were recently amended to lift the 25 percent cap on foreign ownership specified in the original law to effectively 49.9 percent as provided by the Foreign Business Act (FBA). Given recent calls by anti-Thaksin activists to abolish independent bodies established by the 1997 Constitution that have "failed to carry out their duty in providing checks and balances," the commissioners must consider their actions in terms of the NTC's own institutional position in the current political environment.

17. UNHAPPY CONSUMERS: New practical and highly visible problems also require attention, including especially interconnection and number portability. Most important, the sharp increase in subscribers resulting from a price war between AIS and DTAC this year has forced the NTC to grapple with challenge of establishing neutral interconnection charge rules for operators. During peak hours, success rates in completing a connection have fallen to single digits requiring users to make multiple attempts before they can connect. Newspapers publish frequent stories about mobile phone "traffic jams" and cite polls showing that the overwhelming majority of mobile phone users are dissatisfied. A May ABAC poll of AIS, DTAC, and TrueMove (formerly True) customers, for example, found that 77 percent feel they are being "treated shoddily by their service provider." No provider fared particularly well, and 46 percent of respondents said they were dissatisfied with the role of the NTC (38 percent were satisfied and the rest did not know).

18. THE INTERCONNECTION ISSUE AND TOT: Each major mobile phone provider maintains its own network. In the absence of rules

obliging operators to accept incoming calls from other networks in exchange for a portion of the revenue, operators have had limited incentive to build out their switching capacity. Under the current system, unlike in many other countries, the caller's cellular service provider earns money when a call is made, but the receiving network does not earn anything for taking the call. When call volume exceeds interconnection capacity, the default response has been for private operators, particularly the CAT Telecom concessionaires DTAC, TrueMove, and Digital Phone Company (DPC), to route calls through state-owned TOT, which collects monthly fees from them (through CAT Telecom). The recent rise in number of callers and call volume has overwhelmed existing interconnection infrastructure and forced the regulator to act. While the private operators will need to make significant investments to ensure adequate coverage, the elephant in the room is TOT's dependence on the revenue stream from the access fees paid by CAT concessionaires.

According to a Phatra Securities estimate, the net access charges TOT received from DTAC and TrueMove alone made up 11 percent of its 2005 revenue of 60.2 billion baht.

¶9. MORE CONFUSION LIKELY: While the NTC is currently drafting regulations to provide for a new interconnection regime, its approach is to request that the operators prepare offers. Contradictory language in the draft regulations raises the question of whether just the SOEs or all players should prepare offers. Embassy contacts familiar with the drafting process agree that the regulations will allow for TOT to continue to receive the access fees for calls routed through TOT by the private operators. They also think that new regulations providing for revenue sharing should eventually encourage buildout of the infrastructure to facilitate interconnection, which promises to ease the traffic jam. But introducing the new regulations will likely introduce a second accounting system for tracking interconnection charges, thereby adding to the complexity of the regulatory framework.

. . . AND INVESTORS

¶10. SHARE PRICE CHANGES: Investors have taken a hard look at their holdings of listed company shares and adjusted accordingly. As of June 7, Shin Corp had lost nearly 35 percent of its market capitalization since January 23. Shares of AIS closed at 90 baht on June 7, as against a 52-week high of 114 baht and a low of 85 baht.

¶11. CONCESSION NON-CONVERSION: Investors and industry players are also casting aside the familiar conceptual frameworks for understanding the development of the telecom sector going forward. The reality that concession conversion is not on the horizon has finally sunk in. As one foreign analyst expressed the point, "the concessions aren't going to go away until they get CAT and TOT to agree to end them. Otherwise they'll have to wait for another seven or eight years," at which point the SOEs will retain the network assets. More players now expect that the TOT and CAT Telecom will hold out until the concessions terminate. (Note: a list of the principal concessions is set out in REF E. End note.)

¶12. 3G ON HOLD: Last year's hope that NTC-issued licenses for third-generation (3G) technology services offer a regulatory mechanism for the concessionaires to get out of the concession agreements has faded. Service providers have hesitated to go forward in face of the large amount of capital investment required to roll out 3G services, particularly in view of uncertain consumer demand for them, a concern we identified in REF E.

¶13. SPECTRUM NON-ALLOCATION: Although Thai Mobile, a TOT-CAT Telecom joint venture has reportedly been allocated bandwidth in the 1900-2000 MHz range for 3G services under a 2004 (i.e., pre-NTC) agreement with the then (i.e., pre-CAT Telecom) Communications Authority of Thailand, the basic fact weighing on the sector is that the regulatory structure required for allocation of spectrum is not yet in place. Current law set forth in the Radio and Television Frequency Allocation Act provides that both the NTC and the National Broadcast Commission (NBC) must approve new allocation of spectrum, including frequencies required for 3G. The NBC, however, has yet to be formed. In November 2005 the Central Administrative Court ruled to invalidate the final seven candidates named to the NBC when it considered a petition by an unsuccessful candidate protesting irregularities in the selection process. The candidates had been

approved by the Senate but had not yet received royal endorsement. The Prime Minister's Office decided to challenge the decision rather than push for amending the law to give the NTC full authority. The case is pending before the Supreme Administrative Court (SAC). In the unlikely event that the SAC reverses the lower court decision, no one expects the NBC to form in the political environment.

SEARCHING FOR A NEW PARADIGM

¶14. MERGE OR DIE?: In a February 2006 research report entitled "Merge or Die," Richard Moe, the senior telecom analyst at Macquarie Securities, advanced a new framework for the sector. He also radically revised the firm's investment recommendations, identifying TAC rather than AIS as the listed player with the greatest upside potential. Moe is a longtime observer of the Thai telecom scene whose views are widely read, so his change of mind merits attention.

His vision of a market duopoly organized around a TOT/AIS axis and a CAT Telecom/DTAC/TrueMove axis has put the idea of mergers into the public domain, where it is a subject of discussion, including at the NTC. A full duopoly model along the lines set out below, he contends, would create moderate competition and ensure strong cash flows and balance sheets. Two strong telecom operators would be in position to aggressively expand networks, increase quality and range of services, and provide an economic return on investment.

¶15. MERGERS WOULD SOLVE CURRENT PROBLEMS: Beginning with the assumption that the concessions will not be converted, Moe casts aside the article of faith that the private operators will inherit the SOEs telecom networks. Despite their technical and marketing expertise, private telecom concessionaires enjoy limited upside because the terminal values belong to TOT and CAT Telecom. With the right to take over the networks, the SOEs possess assets with real value that could be priced by the market in conjunction with public offerings of TOT and CAT Telecom shares. In this context, mergers of the listed telecom operators with the TOT and CAT Telecom (subsequent to their IPOs) would resolve the concession issues and provide the listed telcos with an indefinite operating life. The problems of life after the concessions, interconnection charges, and over-indebtedness all disappear.

¶16. AND RE-ESTABLISH THAI MAJORITY OWNERSHIP: In Moe's view, some configuration of mergers between the foreign-controlled private operators and the SOEs would also re-establish bonafide Thai majority ownership (he outlines several options), thereby eliminating the political risk for AIS and DTAC stemming from the perceived control of spectrum by foreign government entities, and the foreign control of Thai assets more generally. Politically, he emphasizes, it is difficult to imagine the RTG asking the TOT and CAT Telecom to take a bullet for foreigners, which is the way any effort to strip the SOEs of their revenue under the concessions could be portrayed. Telenor and Temasek are in a weak position to protest termination of the concessions because the contracts were 15 years old and known to them (lenders have always looked at the letter of the contracts rather than assuming that the concessionaires will inherit the assets) and they arguably violated the spirit of the Thai Foreign Business Act. Additionally, the point at which the NTC issues (or does not issue) licenses for 3G services affords the RTG the opportunity to pose a choice between merger and status quo with existing concessions.

¶17. ADDITIONAL BENEFITS: Moe adds that creation of two full-service operators would also provide for more socially equitable reallocation of frequencies. If TOT gave up fixed line concessions, for example, and CAT Telecom gave up DPC and 25MHz of spectrum in an effort to unwind the cross-holdings between the two groups, CAT Telecom would be able to provide cellular service in rural areas and facilitate greater competition there.

¶18. NOT UNPRECEDENTED: While radical in today's environment, Moe's vision is not unprecedented. In 2004, Shin Corp CEO Boonklee Plangsiri said that AIS is a takeover target and TOT is a potential buyer, as Moe is the first to point out. While the idea may be hypothetical for most industry players, for Mr. Boonklee a TOT/AIS merger has an obvious practical value: it opens up the possibility of a new job.

¶19. BUT NOT A SURE THING EITHER: Moe admits the obstacles: distrust among the concerned parties, nationalism, risk of

bureaucratization of the private telcos, and stubborn investor hope for a concession conversion windfall. It is widely known that TOT and CAT Telecom--especially their employee unions--do not trust the private companies, and do not have much use for each other either. Particularly in the current political environment, it is reasonable to expect opposition to the listing of the SOEs on the grounds that they are "national assets". While the unions may over-estimate the long-term financial health of TOT and CAT Telecom, their thinking is a political fact. Additionally, the market is still in denial. Despite Cabinet and NTC statements that the RTG will not force concession conversion, share prices of listed telcos still indicate that some investors expect conversion. Moe readily admits that there may be no mergers, particularly in the absence of someone within government or one of the other entities who champions the idea. His analytical point is that in the absence of mergers, the Thai telecom market structure will remain sub-optimal, with too many players and too much redundant network leading to lower returns on capital. There also exists the temptation to resort to a premature rollout of 3G as a means of unwinding the concessions, which would be wasteful of capital.

DRAFT REGULATIONS ON FOREIGN BUSINESS CONTROL

¶20. MAIN PROVISIONS: The issue of greatest interest to foreign investors that the NTC is presently considering is the draft regulations on foreign business control. First proposed in March, they have undergone several revisions and are still pending. The draft regulations ostensibly constitute the implementing regulations for the revision in the TBA that raised the cap on foreign investment in telecom firms from 25 percent limit in the original TBA to the equivalent of 49.9 percent prescribed by the FBA. They set out standards for what constitutes foreign business control or tendency toward foreign business control and require holders of type 2 and type 3 licenses to report to the NTC. In the case of violations, the telcos are to propose corrective measures. If there is any question of "national security" (the example most commonly discussed, for example, is where an entity owned by a foreign government controls radio spectrum) then the NTC would refer the issue to the competent agency. Sanctions in the case of violation go as far as revocation of a license, but no draft to date has set out a clear schedule of sanctions and in all drafts to date the NTC reserves considerable discretion on how to handle cases of violation. The Commissioners have said, and the Ministry of Foreign Affairs has also confirmed, that the forthcoming draft will include safe harbor provisions that ensure the regulations do not contradict any international commitments undertaken by the RTG, including under the World Trade Organization and in free trade agreements.

¶21. CLOSING A LOOPHOLE? In practice, the FBA has restricted foreign ownership of firms in certain sectors to a minority share, but has allowed foreign control (through such mechanisms as nominee structures and preferential voting arrangements). Telenor and Temasek structured their buyouts of UCOM/TAC and Shin Corp/AIS respectively in such manner. By setting out criteria for what constitutes control, the draft regulations propose to close a loophole that has long existed in Thai business practice. NTC commissioners emphasize that the purpose of the regulations is to put in place a legal process whereby concerns about issues such as "national security" may be evaluated rather than being left to the political process.

¶22. OR SQUARING THE CIRCLE? Industry observers agree and RTG officials privately admit that the regulations are a response to the political furor over the Temasek buyout of Shin. On the one hand, the NTC is responding to domestic political concern about foreign control of what many Thais see as national assets. Hence the specification of criteria for foreign control, and the visible display that the NTC is doing its job. On the other hand, the Commissioners wish to avoid discouraging foreign investment. Thus, the letter of the draft regulations notwithstanding, Dr. Sudharma Yoonaidharma, the Commissioner who drafted the regulations, told foreign diplomats in April, "the regulations seem to be life-threatening things, but they are not. They just trigger disclosure (i.e., to clarify ownership), and the disclosure is the same as required by other agencies." Embassy contacts agree that the reason why it has taken the NTC so long to draft the regulations is the inherent conflict between these two objectives.

¶23. IMPACT UNCERTAIN: Industry observers are divided on the likely impact of the proposed regulations, because it is unclear whether their effect will be to calm the political firestorm over foreign buyouts in the telecom sector without substantive change or to force DTAC and AIS to become "Thai" companies again through divestiture or other means. An attorney who has worked for both Temasek and Telenor emphasized to econoff that the provisions of the regulations, if enforced, would have a negative effect on basic shareholder rights. Other attorneys, also with long experience in Thailand, are more sanguine. If the RTG were seriously interested in limiting foreign control of companies, one emphasized, the NTC regulations would spell out specific thresholds for action on voting rights. They do not. Parliament has had the opportunity to tighten up the law on this issue, and has chosen not to act. The most common opinion among knowledgeable observers expressed to econoffs is that companies will turn to lawyers and advisors to devise new legal solutions to ensure compliance with the letter but not the spirit of the law (i.e., structures that are more sophisticated than the now discredited nominee arrangements but achieve essentially the same end). The Embassy has also confirmed that DTAC, for example, is adjusting some of its positions in advance of the release of the regulations.

¶24. BROADER APPLICATION? A common question among non-Thais is whether the regulations on foreign business control in the telecom sector will set a precedent for similar restriction in other sectors. Legal experts agree that because the telecom sector has its own regulator, its own basic law, and industry and government alike see the draft regulations as being limited in application accordingly, that the direct effect on other sectors will be negligible. Legally speaking, they do not expect any effect until the regulations are tested in court. Several attorneys also indicated to econoff that the RTG authorities can pursue action against a foreign-dominated firm if they so desire under the provisions of the FBA already. Equity analysts, however, see more risk. As one Bangkok-based analyst explained, for investors the problem is not the specific legal content or precedent of the telecom regulations but the broader political environment that prompted the NTC to draft the regulations on foreign control in the first place.

COMMENT:

¶25. The Embassy agrees that the political and regulatory environment in the Thai telecom sector has changed fundamentally as a result of the Shin deal, the political crisis it sparked, and the halt in progress on the Thaksin government's policies of sectoral and trade liberalization. While no one can predict whether the telecom sector will adapt by way of mergers as suggested, we think that the major players need to come to terms with the reality that concession conversion is effectively dead, that the rollout of 3G will be slower and more expensive than envisioned, and that the formation of the NBC and allocation of new frequencies remain on hold. Similarly, the ubiquity of mobile phones in Thailand ensures that the NTC will remain in the political spotlight even in the absence of controversy over deals involving foreign players.

¶26. We also think that, collectively, recent developments represent a net deterioration in the investment and business climate in Thailand's telecom sector. In attempting simultaneously to respond to economic nationalists at home seeking to restrict foreign business activity and to reassure foreign investors, the NTC's draft regulations on foreign business control have rendered Thai policy more, not less, ambiguous. At the very least they promise to have a negative effect on basic shareholder rights. In the current context of political crisis and policymaking paralysis, we expect the RTG to reaffirm its WTO commitment to liberalize the Thai telecom market this year, but to do so in a way that minimizes the change required, most likely by asserting that mobile services are not covered.

BOYCE